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SUBJECT: CENTRAL BANK GOVERNOR WANTS CASH UP FRONT,
CONDITIONALITY LATER

Classified By: Jeffrey Feltman, Ambassador, per 1.4 (b) and (d).

SUMMARY

¶1. (S) Central Bank of Lebanon (CBL) Governor Riad Salameh told the Ambassador in a 11/16 meeting that the IMF team currently in Beirut confirmed that GDP would have 0 percent growth in 2006, down from the 6 percent growth projected in June but considerably better than the 5 percent decline predicted by some after the summer conflict. He claimed that, so far, his interventions to shore up the currency in the ongoing political crisis have been modest and that he had sent a message to Hizballah to stop frightening the markets. Reporting that Lebanon needed to repay USD 9 billion in 2007 (USD 3 billion of which in foreign currency), Salameh pleaded for an upfront payment of about USD 2 billion in grants or highly concessional loans at the January Paris III conference to give confidence to the markets. After that initial payment, conditionality should be imposed on further help, he said. Using interest rate differentials from Paris II to argue his case, Salameh downplayed any significant role for the commercial banks in debt relief. He said that he did not support a formal IMF program because of the political backlash that would result. But he wanted to work so closely with the IMF that Lebanon would have a program in everything but name. Salameh defended his record on the Bank al-Medina scandal against recent public criticisms by Minister of Justice Charles Rizk. While acknowledging his presidential ambitions, Salameh calculates that his chances are better if he continues to focus on his current job rather than appear overly eager. Fellow presidential aspirant Michel Aoun was falling short of his goals to raise money for Orange TV, Salameh reported, adding that he was keeping a close eye out for money-laundering through the Orange TV financing. End summary.

ZERO PERCENT GROWTH RATE
(BETTER THAN MINUS FIVE)

¶2. (C) Salameh said that the IMF technical team currently in Beirut confirmed that the worst macroeconomic predictions after the summer's conflict and subsequent blockade, of a 5 percent decline in GDP, were proving not to be true. Instead, Salameh said, Lebanon will have 0 percent growth. That already is a blow, he said, given that, in June, economists were predicting 6 percent growth for 2007.

POLITICAL CRISIS NOT YET AFFECTING

FINANCIAL MARKETS SIGNIFICANTLY

¶13. (C) Salameh said that the ongoing political crisis provoked by the March 8-Aoun demand for a blocking minority in the cabinet had not, so far, shaken the confidence of the financial markets. Despite claims in the pro-Syrian press that he had to intervene to the tune of USD 175 million in a single day to maintain the Lebanese pound, Salameh claimed to have expended only USD 50 million total to bolster the currency since the political crisis began several weeks ago. He credited the relative stability of the financial markets to "trust in the team" -- himself, Prime Minister Siniora, and Finance Minister Azour. The CBL in particular has a good reputation, having steered Lebanon's financial markets through crisis after crisis over the past two-plus years.

PASSING A MESSAGE TO HIZBALLAH:
STOP FRIGHTENING PEOPLE, KEEP SINIORA

¶14. (C) Nevertheless, expressing concern about the impact if the political impasse continues "for more than a couple of weeks," Salameh said that he had passed a message to Hizballah to stop frightening the financial markets with talk of demonstrations and protests. He claimed to have told Hizballah that "getting rid of Siniora is crossing a red line," given Siniora's soaring reputation internationally and especially in the Arab world. The Ambassador asked Salameh whether he thought Hizballah cared. "They should -- I told them that, if they shut down the economy by blocking the airports, ports, and bridges, then they are acting like Israel." He claimed that Hizballah responded that it would not go to extremes. Asked whether he had passed a similar

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message to Michel Aoun, Hizballah's co-conspirator, Salameh responded that it would do no good, because "Aoun is crazy. He will destroy the country to become president."

2007: USD 9 MILLION IN DEBT COMES DUE
AND SALAMEH SEEKS UP-FRONT HELP

¶15. (C) On the debt situation, Salameh said that Lebanon would have to refinance approximately USD 9 billion in 2007. Of that, USD 3 billion is in foreign currency. Given the shock to Lebanon from the summer conflict and subsequent blockade, Salameh argued that Lebanon needs an upfront contribution at the January Paris III conference of about USD 2 billion in grants (preferably) or highly concessional loans. This will give confidence to the markets.

"NOT WORTH" APPROACHING COMMERCIAL BANKS

¶16. (C) The Ambassador asked about the contributions of the Lebanese commercial banks, the holder of well over half of Lebanon's debt. Salameh said that, unlike at Paris II in November 2002, the banks should not be involved. "It's not worth it," he said. Heading into Paris II, he argued, interest rates on the debt averaged 14 percent. By offering USD 4 billion at 0 percent, the commercial banks at that time saved the GOL USD 700-800 million a year. Now, with interest rates averaging only 8 percent, the savings to the GOL would only be about USD 300 million. "The banks will scream," and deposits might drop in the resulting hullabaloo. The Ambassador noted that the banks have something like USD 65 billion of deposits and surely can be expected to play some kind of role. Salameh suggested approaching the banks after Paris III, not before, when it was clear that there would be some conditionality on the GOL. Then, the banks might be willing to do voluntary contributions.

SEEKING SOMETHING SHORT OF AN IMF PROGRAM

¶7. (C) The Ambassador asked about conditionality and an IMF program. Salameh said that the USD 2 billion he believes Lebanon needs upfront at Paris III should be unconditional -- or presented as a down payment on future conditionality. But a program should be agreed upon by which future contributions are conditioned on realistic reform goals. This, he said, will provide discipline and incentives. The Ambassador asked whether Salameh now supported an IMF program. Giving a long explanation, Salameh said that he thought that, in the current political climate, trying to go for an IMF program would be counterproductive. Pushing an IMF program would be giving Hizballah and Michel Aoun a "gift," as they will surely promote populist resentment against it and use it to attack the GOL. An IMF program will make real reforms harder. Salameh said that, nevertheless, he agreed that IMF-monitored benchmarks were essential for donor confidence. Eventually, he explained that what he had in mind was a "partnership" with the IMF that would be essentially a "soft IMF program" without the name.

DEFENDING HIS RECORD ON BANK AL-MEDINA

¶8. (C) The Ambassador asked Salameh's reaction to Minister of Justice Charles Rizk's claim that Salameh should have used a 1967 law passed in the aftermath of the IntraBank collapse to lift bank secrecy on Bank al-Medina. How does Salameh respond to Rizk's charge that Salameh's failure to use this law had hindered judicial investigation of the scandal and protected many criminals? Salameh responded that the law Rizk cited depends on declaring the bank bankrupt. That would have put 14,000 depositors at the mercy of court proceedings in Lebanon, which can take decades. Salameh's approach was to take over the bank and find ways to pay off the depositors. That happened: none of the individual "little depositors" lost savings. Surely that was a preferable approach. The fact that only one person -- Rana Qoleilat, the bank's director -- has been prosecuted for the scandal is a reflection of slow action by Rizk's ministry, not because of Salameh's actions.

PRESIDENTIAL AMBITIONS, YES

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¶9. (C) Like most observers, Salameh ascribed Rizk's Bank al-Medina references to Rizk's presidential ambitions: Rizk hoped to eliminate Salameh as a competitor. In Salameh's view, Rizk had put the stake through his presidential ambitions with his televised Bank al-Medina statements, as Rizk appeared opportunistic and too eager. Acknowledging that his name is circulating with increasing frequency as a potential presidential candidate, Salameh said that he does not deny that he believes his management of the CBL should make him eligible. But he said that he had concluded that it is not worth fighting for the presidency, that his chances are better if he keeps concentrating on his current job. Perhaps, he laughed, the presidency will simply land in his lap. The Ambassador noted that he and Prime Minister Fouad Siniora do not like each other: with the Hariri camp perhaps renominating Siniora as premier when a new president takes office, would Salameh be able to work with Siniora? Salameh claimed that, whatever their personal differences, both recognized after watching the Rafiq Hariri-Emile Lahoud spats that, for Lebanon to be successful, the president and prime minister must act as partners. After his experience with Lahoud, Siniora certainly must know that now, Salameh said.

MICHEL AOUN: DISAPPOINTING RESULTS
IN RAISING CAPITAL FOR ORANGE TV

¶10. (S) The Ambassador asked Salameh about rumors that Michel Aoun's attempt to raise capital for his proposed

Orange TV network masked an elaborate Hizballah-Qatari money-laundering operation. Salameh acknowledged the rumors, saying that he, too, was concerned about the methods Aoun was using to get cash: call-in numbers, publicized bank accounts to which people can contribute money, etc. Aoun has opened Orange TV accounts in three banks, Salameh said, and he has given strict warnings to the banks to scrutinize the accounts quite closely. So far, Salameh said, he is confident that the accounts are not being used for money-laundering.

Perhaps the best evidence of this, he said, is that, after weeks of a high-profile campaign for "the people" to buy shares, Orange TV has garnered only USD 14 million. That is far less than the USD 50 million that Aoun needs to operate the station each year, Salameh estimated.

FELTMAN